

What is the Small Business Exception to IRC § 471's Requirement to Maintain Inventories and How Many Businesses Can Take Advantage of It?

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Administrative exceptions to code sections and/or treasury regulations often trigger tax policy queries. Chiefly, how are taxpayers impacted? How many taxpayers will be affected? Who are these taxpayers? Two such exceptions: Rev. Proc. 2001-10 and Rev. Proc. 2002-28 are examined. These Revenue Procedures provide exceptions for small businesses from general statutory/regulatory mandates to maintain inventories, use accrual accounting, and capitalize direct and indirect costs. Rev. Proc. 2001-10 targets businesses with significant inventory activity, while Rev. Proc. 2002-28 is directed at non-inventory/service providers for whom it is unclear whether such providers are selling merchandise and if that sale of merchandise is an income-producing factor. This article surveys pertinent choice of accounting method rules for tax purposes and briefly examines the technical requirements of the above Revenue Procedures to answer the first of the above three questions. Then relevant IRS Statistics of Income (SOI) data tables are analyzed to answer the latter two questions. The SOI statistics indicate that there are approximately 4,407,968 small businesses that appear to qualify for Rev. Proc. 2001-10 relief—52.7% of which are sole proprietorships in the retail trade sector.